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POLICY BRIEF

Improving Budgetary Practices in Illinois

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Illinois is mired in a fiscal crisis. Why? Because for decades, lawmakers have spent more than sustainable inflows of revenue and covered the gap partly with revenue from temporary sources and partly by issuing promises to pay later. When a temporary revenue source goes away, the spending it supported does not. Each new IOU represents a "legacy cost," a claim on future revenue that compounds fiscal problems in subsequent years.[1]

The "what can we do now?" discussion in Illinois has generally focused on the content of the state's budget: where to cut spending, where to raise more revenue, and how to balance the two. Yet also important is the set of rules, procedures and reports with which the state manages and communicates budget actions. The buy-now, pay-later content choices of the past were facilitated—even disguised—by then-existing procedural and reporting practices. Reform of these practices would improve budget transparency and accountability, and help prevent Illinois from getting into such dire fiscal straits in the future.

In this report, we first discuss a set of principles for sound budgetary practice, then evaluate actual practices in Illinois, and find that Illinois has bent or broken every principle. We outline five ways that Illinois can improve budget practices going forward.

BUDGET CONTENT VS. BUDGET PRACTICES

It is important to distinguish between budget content and budget practices. As Illinois tries to manage its large budget deficit, policy choices about future budget content will be contentious. Revenue will have to be increased and/or spending will have to be cut. No one—policymakers nor voters—likes either of these actions. There will be many losers, and on balance, more losers than winners. Business versus labor, rich versus poor, old versus young, urban versus rural, are just some of the opposing factions that are created by choices about higher taxes and spending cuts. Illinois' large structural deficit and legacy of unfunded liabilities forces choices among a variety of unappealing alternatives.

On the other hand, the reform of budget practice offers more win-win opportunities. Better design of the procedures that determine how fiscal choices are made and how budget information is communicated can clarify costs and benefits. In particular, this can highlight the magnitude and severity of budget problems that may exist. Without these reforms, budget problems can be hidden from view and allowed to fester and grow until they are too severe to ignore—and much harder to solve. In other words, budget practice reforms will lead to better information and make constraints more visible. That could encourage more responsibility and discourage choices and actions like those that got Illinois into its current fiscal mess.

Governmental budget problems can, of course, be traced to a number of sources. Some stem from natural disasters, cyclical instability or structural economic decline and as such may be beyond the control of governing authorities. Others are attributable to political or ideological polarization that makes compromise unattainable. But some budget problems arise because of less-than-optimal design of technical budgetary practices. While debate on budget content will always be contentious, Illinois policymakers can achieve consensus on budget practice reforms to help stave off future crises, thereby making debates about budget content more constructive.

[1]Dye, R., Hudspeth, N., & Crosby, A. (2015, January 19). *Apocalypse Now? The Consequences of Pay-Later Budgeting in Illinois: Updated Projections from IGPA's Fiscal Futures Model.* University of Illinois Institute of Government and Public Affairs. http://igpa.uillinois.edu/system/files/FF_Apocalypse_Now_Jan_2015.pdf

FUNDAMENTAL PRINCIPLES OF SOUND BUDGETARY PRACTICE

Principle I
ADVANCE PLANNING

Engage in multiyear financial planning and reporting. Budgeting should be forward-looking and informed. Decisions made in one year often affect many future years. The end or decline of certain revenue streams can be foreseen and should be planned for. Economic and fiscal changes should be anticipated and planned for in advance.

Principle II
SUSTAINABILITY

Avoid time-shifting of payments for current operations. It is unfair to future taxpayers to send them the bill for prior years' purchases. Current services should be paid for currently. When some compensation for current labor services is deferred, as with the promise of future pensions, the burden on future taxpayers can and should be offset by the accumulation of financial assets. One-time revenue should be identified and should not be the funding source for ongoing programs.

Principle III
FLEXIBILITY

Plan for shocks or cyclical fluctuations in revenue inflows or spending needs. Revenue inflows and program costs can be expected to vary over time. Reserve funds can be accumulated in good years and expended in bad.

Principle IV
TRANSPARENCY

Issue meaningful, clear, consistent and timely budget and financial reports. In order to understand the content and consequences of the budget choices, they must be communicated in an easy to understand way.

ILLINOIS' CURRENT BUDGETARY PRACTICES ARE IN NEED OF REFORM

Illinois' budgetary practices are badly in need of reform. In this section we evaluate existing practices in Illinois with respect to the principles of sound practice (presented above and in more detail in the Appendix).

Principle I
ADVANCE PLANNING
Illinois needs to look at the long term.

A. Illinois' multiyear projections of sustainable revenue and current service spending are not comprehensive.

In 2010, new laws required the Governor's Office of Management and Budget (GOMB) to report on fiscal policy intentions looking ahead three fiscal years[2] and required the General Assembly's Commission on Government Forecasting and Accountability (COGFA) to project General Fund revenue ahead three fiscal years.[3] However, spending projections on a current service basis—i.e. under current law—are not required. And, unlike many other states, Illinois does not engage in consensus revenue forecasting, which is recommended by fiscal experts as a way to combine multiple forecasts to create a common view of the coming fiscal year. As part of the annual budget process, GOMB and COGFA both produce revenue estimates but there is no established practice for reconciliation.

B. Illinois does not routinely estimate the future expense and revenue impact of major legislation.

Thirty-nine states produce what are referred to as *fiscal notes*, or some form of cost estimate for legislation. Most states produce estimates for at least one year, and some produce five-year cost estimates. Although the Illinois General Assembly has a procedure in place to prepare fiscal notes, they are rarely issued and, according to a recent study, when used, they are often employed as a tactic to delay or kill a bill rather than as a budget-planning tool.[4]

C. Illinois lacks an annually updated capital plan.

A recent IGPA report evaluates capital planning in Illinois and finds it wanting in a number of ways: (a) capital planning is not ongoing, instead separate multi-year plans

[2] Illinois Public Act 96-1354 of July 2010. http://www.ilga.gov/legislation/publicacts/96/096-1354.htm

[3] Illinois Public Act 96-0958 of July 2010. http://www.ilga.gov/legislation/publicacts/96/096-0958.htm

[4] Hudspeth, N. (2014, March 25). *The Illinois Budget Policy Toolbox: Better Fiscal Planning.* University of Illinois Institute of Government and Public Affairs. http://igpa.uillinois.edu/sites/igpa.uillinois.edu/files/toolbox-budget/files/Hudspeth-Fiscal-Planning-web.pdf

have been enacted on an irregular basis; (b) each plan relies on the adoption of new revenue sources; (c) plans do not evaluate and rank projects based on the critical needs of the state, but on the location of individual legislators' districts.[5]

D. Illinois relies on single-year, cash-basis accounting.[6]

Illinois relies on cash-basis accounting at the budget preparation, legislative approval, and execution stages of the budget cycle. This method of accounting records receipts (e.g., tax revenue) when they are received and expenses only when they are paid, rather than looking at the longer term. Cash accounting is akin to an individual only looking at the payment due in the current month on a credit card, rather than looking at the total balance due. The state's consolidated annual financial report (CAFR), is not issued until many months after the fiscal year has ended. The CAFR does report on an accrual basis but usually does not help lawmakers do advance planning or understand the implications of time-shifting budget actions during budget negotiations.

Principle II
SUSTAINABILITY
Illinois cannot continue paying its bills with IOUs.

A. Illinois does not set aside sufficient funds to honor promised payments to future retirees.

1. *Pensions.* Illinois has not adequately prefunded its pension obligations as recommended by the Governmental Accounting Standards Board (GASB). GASB's Actuarially Required Contribution (ARC) is the sum of "normal cost," which is the change in future pension liabilities attributable to the current year of service of existing employees, and a yearly "amortization cost" payment calculated to eliminate unfunded pension liabilities—and achieve 100 percent funded status—over a period of 30 or fewer years.

Illinois' pension payments are instead based on a 1994 law targeting 90 percent funded status over a 50-year period.[7] Also, both in the 1994 statute and many subsequent actions, Illinois has persistently relied on back-loading (delaying until later years) the pay-down of unfunded liabilities.
As of June 30, 2014, the combined unfunded pension liability for Illinois' five state-financed retirement systems[8] was $111.2 billion and pension plan assets covered only 39.3 percent of liabilities.[9] This worst-among-states funding status is a consequence of Illinois paying significantly less than the actuarially required amount for decades. One reason this could go on for so long without public outcry is the use of cash-based accounting. In FY2014 for example, prospective budget documents included only the $6.9 billion scheduled pension contribution, not the information that this was $760 million below ARC and would thus increase unfunded liabilities.[10]

The state must eventually deal with pension legacy costs. In May 2015, the Illinois Supreme Court struck down a law that tried to reduce pension liabilities by changing how benefits are calculated, declaring that existing rules for promised pensions are contracts protected from "non-impairment" by the state constitution.[11,12]

2. *Other post-employment benefits.* Illinois does not put aside assets to fund promises to pay healthcare benefits to former employees after they retire. The most recent estimate of the amount of Illinois' unfunded liability for healthcare benefits is $34.5 billion.[13]

B. Illinois borrows for current operations.

Illinois has used borrowed funds to balance its operating budget. For example, Illinois issued bonds to cover its statutory annual pension contributions in two recent years—$3.5 billion in 2010, and $3.7 billion in 2011.[14] Partly as a consequence, debt service costs have increasingly crowded out spending on other priorities. Illinois' spending on debt service increased from approximately 7 percent of general funds spending in 2006 to slightly more than 10 percent in 2014.[15]

Borrowing for current operations is unfair to future taxpayers who are forced to pay for past services. On the other hand, borrowing—spreading out payments over a number of years—for the purchase of infrastructure improvements that last for roughly the same years does

[5]Luby, M. J. (2015, September). *State of Illinois Debt Affordability Report With Application to Infrastructure Funding Capacity.* University of Illinois Institute of Government and Public Affairs. http://igpa.uillinois.edu/system/files/State-of-Illinois-Debt-Affordability-Report-IGPA.pdf

[6]Cash accounting reports only receipts and payments in the budget year. Accrual accounting also records changes in assets or liabilities attributable to the budget year. For example, current-year wages and salaries of state employees are included in the cash budget, but the corresponding obligation the state accrues to pay pension benefits to current workers in future years is not.

[7]Brown, J. R., & Dye, R. F. (2015, June). *Illinois Pensions in a Fiscal Context: A (Basket) Case Study*. In National Bureau of Economic Research. http://www.nber.org/papers/w21293.pdf

[8]The five state-finance systems include: Teachers Retirement System (TRS), State Employees Retirement System (SERS), State University Retirement System (SURS), Judges Retirement System (JRS), and General Assembly Retirement System (GARS).

[9] State of Illinois Comptroller Leslie Geissler Munger. (2015, March 12). *Comprehensive Annual Financial Report: Fiscal Year Ended June 30, 2014.* http://ledger.illinoiscomptroller.com/ledger/assets/File/CAFR/CAFR_2014.pdf

[10]For convenience, this calculation uses post-year-end ARC numbers from Illinois' FY14 CAFR. ARC measured prior to the start of the fiscal year might differ slightly.

[11]Heaton et al. v. Quinn. 2015 IL 118585. Illinois Supreme Court. Filed May 8, 2015. http://www.illinoiscourts.gov/opinions/supreme-court/2015/118585.pdf

[12]See footnote 7.

[13]See footnote 9.

[14]Luby, M. J. (2015, September 7). *All Bad Things Come in Threes: Illinois' Third Type of Deficit: Infrastructure Funding.* University of Illinois Institute of Government and Public Affairs. http://igpa.uillinois.edu/system/files/Infrastructure-Funding-Deficit-Illinois-IGPA.pdf.

[15]See footnote 14

not violate the principle of sustainability. Debt service payments for other purposes, like pension obligation bonds, diminish the capacity of the state to borrow to purchase infrastructure and other long-lived physical assets. As of 2014, Illinois ranked fifth in the nation in total borrowing ($33.2 billion), seventh in per-capita borrowing ($2,580), and ninth in debt as a percentage of personal income (5.6 percent).[16]

C. Illinois often delays payment for current operations.

1. *Illinois' unpaid bills to providers of state services continue to increase.* In recent years, Illinois has delayed payments to its vendors as a means of financing deficit spending. This not only delays the payment of obligations to future fiscal years—thereby increasing fiscal stress—but it also increases costs because Illinois must pay interest to vendors when it delays payments. In essence, it is like a consumer living on credit card debit. It is an expensive way to deal with financial problems. As of September 2015, Illinois was on track to have $8.5 billion in unpaid vendor bills by the end of December, not counting another $4 billion owed to state universities, lottery winners and others.[17]

2. *Illinois pays for expenses of one fiscal year with revenue of the next.* In addition to not paying its bills on time, Illinois has also routinely shifted many expenses to future fiscal years. For example, Section 25 of the Illinois State Finance Code allows liabilities for Medicaid as well as state employees' and retirees' health insurance incurred in one year to be paid in a subsequent year. Although Medicaid reform legislation requires a phase out of this practice by FY2021, Illinois continues to shift some bills to the future.[18]

D. Illinois has a history of selling assets to pay for current operations.

For example, in 2010, Illinois sold $1.46 billion in bonds by pledging—effectively selling—payments due the state in future years as settlement of a lawsuit with tobacco companies. The transaction was "structured … to make sure it sold easily," i.e., it was generous to investors at the expense of the state; it netted Illinois $1.3 billion that was used to pay current bills.[19]

E. Illinois has relied on non-recurring revenue to pay for on-going program operations.

For the last 10 years, Illinois has relied on a series of temporary revenue surges—the tax collections bubble of 2005-2008, federal stimulus funds in 2009-2011, and the temporary income tax increase of 2011-2014—without addressing the underlying structural gap between spending and sustainable revenue.[20]

F. Illinois defers maintenance of infrastructure assets.

A recent report labeled Illinois' infrastructure funding as the state's "third type of deficit." The report explains: "By failing to maintain, replace and improve its infrastructure and other physical capital assets, Illinois has limited the future productivity and income-earning ability of its workers and businesses."[21] In other words, Illinois is not paying for wear and tear on infrastructure as it occurs, piling up expenses for the future. Furthermore, by failing to undertake sufficient routine maintenance, Illinois will suffer even more expensive problems down the road.

Illinois' infrastructure, already in poor condition for years, worsened as the state has struggled to pay its bills. The percentage of roads in fair or poor condition rose from just over half in 2011 to 73 percent in 2013.[22,23] But because of the underlying structural deficit, high levels of bonded debt service costs relative to other states, and large legacy liabilities for pensions and OPEB, there is little state funding available to address the large and growing backlog of infrastructure needs.

G. Illinois does not routinely document or account for time-shifting of its revenue or expenditures.

One recent example of this is the failure to explicitly discuss or document the fiscal consequences of suspending corporate income tax filers' right to deduct net losses from taxable income in the period from January 2011 until January 2015. Under this suspension, an important device used to reduce corporate tax liabilities was delayed but not eliminated. As a consequence, calendar year 2015 corporate tax revenue will be reduced at a time when Illinois has a crucial need for additional money. This predictable consequence was little known to those unfamiliar with arcane technical details of corporate tax accounting.[24]

[16]See footnote 14.

[17]Hinz, G. (2015, September 9). Illinois IOUs growing fast, could pass $8.5 billion by yearend. *Crain's Chicago Business.* http://www.chicagobusiness.com/article/20150909/BLOGS02/150909828/illinois-ious-growing-fast-could-pass-8-5-billion-by-yearend

[18]Dye, R., Merriman, D., Hudspeth, N., & Crosby, A. (2013). *And Miles to Go Before It's Balanced: Illinois Still Faces Tough Budget Choices.* University of Illinois Institute of Government and Public Affairs. http://igpa.uillinois.edu/IR13/pdfs/IR13_CH2c_Fiscal.pdf

[19]Merrion, P. (2010, November 30). Investors inhale Illinois' $1.5B tobacco bonds. *Crain's Chicago Business.* http://www.chicagobusiness.com/article/20101130/NEWS02/101139991/investors-inhale-illinois-1-5b-tobacco-bonds

[20]See footnote 1.

[21]See footnote 14.

[22]State Budget Crisis Task Force. (2012, October). *Report of the State Budget Crisis Task Force: Illinois Report.* http://www.statebudgetcrisis.org/wpcms/wp-content/images/2012-10-12-Illinois-Report-Final-2.pdf.

[23]United States Department of Transportation. (2015, July 9). *Road and Bridge Data by State.* https://www.transportation.gov/policy-initiatives/grow-america/road-and-bridge-data-state

[24]See Plante & Moran. (2012, February 28). *Illinois NLD Suspension: What This Means If You Are Thinking of Selling.* http://www.plantemoran.com/perspectives/articles/2012/Pages/illinois-nld-suspension-what-this-means-if-you-are-thinking-of-selling.aspx

H. Illinois does not routinely identify non-recurring revenue in budget documents.

However, some summary reports do label and group revenue sources in a way that distinguishes flow of state taxes and federal aid from borrowing, fund balance changes, and clearly one-time sources like the sale of a 10th riverboat casino license.[25]

<u>**Principle III**</u>

FLEXIBILITY

Illinois needs to plan for rainy days.

Many of the budget practices that have contributed to the deepening of Illinois' fiscal problems—like drawing down fund balances, payment delays or modest borrowing—might be appropriate in certain circumstances on a limited basis, but they are unsustainable and dysfunctional if used year after year. A complement to long-term planning is explicit planning for short-term fiscal flexibility with specific and well-designed policies.

Illinois has no true rainy day fund. Illinois did not establish its Budget Stabilization Fund until May 2000, years after most other states had already done so. But the state failed to make adequate deposits into this fund. While the best-practice guideline is that rainy day funds should hold at least 5 percent of General Fund revenue, Illinois' Budget Stabilization Fund has fluctuated from zero to 1 percent.[26]

<u>**Principle IV**</u>

TRANSPARENCY

Illinois needs to issue clear and consistent reports.

A. Illinois creates confusion by changing budget scope and categories across years (fund-shifting).

1. *Illinois policymakers and budget observers focus almost exclusively on the general funds.* For years, Illinois has focused most of its budgeting and financial management discussions on its four general funds. However, these four funds represent less than half of the total state budget. Illinois has hundreds of special funds and these funds should be included in financial documents and discussions.[27]

2. *Illinois does not clearly identify revenue transfers and spending responsibility shifts between budget categories.* In FY2015, the state addressed a $1.6 billion mid-year budget hole primarily by transferring $1.3 billion from special funds revenue to the general fund.[28] Notably, a number of these fund sweeps only exacerbate the state's ongoing infrastructure deficit outlined above. These fund sweeps are not intended to be repaid and are not recurring revenue, but rather were a temporary measure to help the state limp through an intentionally unbalanced budget year. These financial actions should be clearly identified in budget discussions and financial reporting.

Scrutiny of budget proposals inevitably requires comparisons across time. Programmatic and departmental reassignments of functions and responsibilities are often appropriate as priorities and resources evolve and strategies for governmental involvement change. When such reorganizations occur, it is vital that they be clearly explained in budget documents. Whenever possible, cross-walks should be provided so that budgetary effort and resources can be compared over time.

B. Illinois' online budget information is accessible, but could be improved.

Illinois provides detailed data for revenue and expenditures for the current and several recent years via the Illinois Comptroller's website. However, there are problems with the timeliness, understandability, and cross-year consistency of that information.

C. Illinois struggles to make financial information available on a timely basis.

For example, in 2013, Truth in Accounting rated Illinois as "tardy" in the release of its Comprehensive Annual Financial Report (CAFR), with 243 days to release. Only four states had longer delays.[29]

FIVE WAYS ILLINOIS CAN BREAK ITS BAD HABITS AND MOVE TO SOUNDER BUDGETARY PRACTICES

Many of Illinois' budget practices examined above have contributed to or enabled the worsening of the state's fiscal crisis. And each problematic or dysfunctional practice implies reforms that could either restrain such actions in the future, or more clearly inform Illinoisans of the content and consequences of such actions going forward. Our short list of principle-based reform options for Illinois includes:

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[25]E.g., COGFA's recent monthly report on General Funds Receipts in http://cgfa.ilga.gov/Upload/1015revenue.pdf

[26]Commission on Government Forecasting and Accountability. (2014, March). *3-Year Budget Forecast FY 2015 – FY 2017*. Illinois General Assembly. http://cgfa.ilga.gov/Upload/2014ThreeYearBudgetForecast-FY2015-FY%202017.pdf

[27]Dye, R., Hudspeth, N., & Merriman, D. (2011, July). *Why Ignore Over Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting.* University of Illinois Institute of Government and Public Affairs. https://igpa.uillinois.edu/system/files/FiscalFuturesBudgetTransparencyReport.pdf

[28]The Civic Federation. (2015, April 3). Illinois Approves Fix for FY2015 Budget Gap. http://www.civicfed.org/iifs/blog/illinois-approves-fix-fy2015-budget-gap.

[29]Truth in Accounting. (2014, September). *The 2013 Financial State of the States.* http://www.truthinaccounting.org/library/doclib/2013-FSOS.pdf

1. Refine and expand multiyear budget planning in Illinois. The three-year budget projections now produced by COGFA and GOMB are an important start, but there are a number of opportunities to expand and improve these efforts: increase the projection period to five or more years; broaden the scope of projections to more than just the general funds; include projections of current-service spending based upon careful analysis of the factors that drive each separate spending category.

These projections should also be accompanied by estimates of changes in major liabilities for the projection period. For example, the most recent COGFA report on pensions has projections of the change in unfunded liability in future years. Anticipated changes in bonded debt from the most recent capital plan are also relevant.

Illinois policymakers should also create a well-designed capital plan and update it annually. The plan should include debt affordability analysis and an assessment of infrastructure needs. Capital spending should be funded by sustainable sources of revenue.

2. Require meaningful *fiscal notes* to accompany any legislation with a significant impact on future revenue flows or spending obligations. The benefits of rigorous estimates of costs over time for political and popular discussion of new initiatives are obvious. But this cannot be done without expanding the resources of COGFA or a similar entity.

3. Modify cash-only budget reporting to include significant changes in liabilities and assets. Implementation of accrual accounting for prospective budgets may not be feasible for Illinois. But cash-only budgeting has not shown the time-shifting consequences of many of the questionable budget actions of the past. A middle ground could be to require supplementary information on significant changes in liabilities or assets appended to the governor's proposed budget and the version of the budget passed by the General Assembly. Examples of such changes include the increase in unfunded pension liabilities due to a state contribution less than the ARC, the increase in unfunded OPEB liabilities, and new debt.

4. Clearly identify non-sustainable or one-time revenue sources in budget reports. Most of the information is already there for those who know what to look for, but non-recurring sources could be clearly, routinely, and comprehensively identified.

5. Adopt a broad-based budget frame with meaningful spending and revenue categories consistently defined over time. Tracking Illinois budgets over time or understanding how much of any year-to-year change is real versus a mere accounting change is very difficult, even for public finance experts. The emphasis in budget reports on only the general funds effectively ignores roughly half of all annual state revenue and spending that flows through various special funds. Revenue transfers or spending shifts in and out of the general-funds-only reporting frame make it very difficult to track what is really going on. The confusion and non-transparency caused by fund-shifting has been an enabling factor in the growth in Illinois' fiscal problems over the last decade or more. The broader the scope of the budget reporting frame, the narrower is the chance for confusion from cross-fund movements. •

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The Fiscal Futures Project began in 2008 out of concern that the state of Illinois lacked sufficient capacity to project its fiscal demands and revenue streams into the future. A longer term perspective is needed due to: (1) The structural deficit: state expenditures have been growing faster than revenue (2) The serious consequences of making policy choices while ignoring the impact on the budget in future years (3) The relentless pressure on future budgets from an aging population and continuing increases in the cost of health care.

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APPENDIX
FUNDAMENTAL PRINCIPLES OF SOUND BUDGETARY PRACTICE

There is no shortage of ideas to reform budget practices in Illinois. Some recommend best practices for any state or local government.[1] Some take the form of "scorecards," that grade governments on the presence or absence of certain practices.[2] Some are specific to Illinois.[3] But instead of reviewing the many lists, we believe it is important to establish some fundamental principles.

Textbook treatments divide the government budget cycle into four parts: (1) budget preparation, (2) legislative budget approval, (3) budget execution, and (4) audit and evaluation. One key to good budget practice is assuring consistency across parts of the cycle and between multiple budget cycles. Each of the principles discussed below applies to one or more parts of this cycle. In many cases, the principles require links between several parts of the budget cycle. For example, the documents used in the budget preparation and legislative budget approval phases of the cycle should be closely linked to the structure and content of reports prepared in the audit and evaluation phase.

We distill our understanding of sound technical budgetary practices into four basic principles presented on the following page.

By design, these principles require budget practices that accurately depict decision makers' options and enable clear discussion of trade-offs among competing uses for scarce resources in each phase of the budget cycle. Advance planning, including multiyear financial reports, would affect the budget preparation, legislative approval and audit and evaluation phases of the budget cycle. It is not imperative that the executive formally propose multiyear financial plans during the budget preparation stage, but budget proposals should include data and information about the implications of current year choices for future revenue and spending. Doing this would make evident use of temporary revenue and spending. Revenue and spending should be forecast using professional, transparent and objective methods. A consensus revenue forecast is one way to encourage this objectivity. Forecasts of spending under current policy in future years, using professional, transparent and objective methods also encourage objectivity.

The legislature should have the analytical capacity to understand and compute changes in multiyear forecasts implied by its revisions to executive budget proposals. Fiscal notes, which analyze the fiscal implications of legislative proposals, should be used for any major initiative and should be considered early in the process.

Finally, during the audit and evaluation phase of the budget cycle, analyses should facilitate multiyear comparisons. In particular, when government departments and programs are re-organized there should be a cross-walk that makes it possible to compare revenue, spending and performance with earlier and later years.

Principle II is designed to assure that budgetary choices are consistent with fiscal sustainability. In one sense, well-designed advanced planning, multiyear budget reports, and/or accrual accounting perform functions similar to Principle II. Sustainability requires, however, not only knowledge of the future implications of current choices but also disciplined budgetary practices that avoid unfunded liabilities. Principle II operates in each phase of the budget cycle. In particular, this principle requires that during budget execution the executive branch appropriately expends resources for maintenance and investment.

Principle III emphasizes the need for budgeting practices with sufficient flexibility to respond to unanticipated events, especially cyclical economic disturbances. Sound budgeting practice requires availability and occasional timely use of revenue "cushions" to stabilize spending when conditions warrant. The executive branch must plan for such cushions in the budget preparation phase and the legislature must approve their use. These resources should be rapidly deployed and accurately targeted when needed during budget execution. Rules that reduce political and administrative delay when use of these funds is appropriate must be in place.

Principle IV is perhaps the most fundamental sound budgetary practice because it underlies all of the others: budgetary decisions and reports must be transparent. This requires that data be made available in an accessible, timely, clear and, perhaps most importantly, comprehensive and consistent manner. State government budgets are complex and massive endeavors with many inter-connected items that change frequently. Budget documents must reflect this complexity but should distill essential fiscal facts accurately. Relatively arbitrary categorizations like general and non-general funds should not be allowed to distort budgetary reports. Reports should provide sufficient information for anyone to rapidly understand how resources are being deployed and to compare overall resources with expenditures.

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[1]E.g., State Budget Crisis Task Force. (2012, July). *Report of the State Budget Crisis Task Force: Full Report.* http://www.statebudgetcrisis.org/wpcms/wp-content/images/Report-of-the-State-Budget-Crisis-Task-Force-Full.pdf

[2]E.g., Truth in Accounting. (2015, September). *2014 Financial State of the States.* http://www.truthinaccounting.org/news/detail/2014-financial-state-of-the-states.

[3]E.g., Institute for Illinois' Fiscal Sustainability at the Civic Federation. (2014, March 3). *State of Illinois FY2015 Budget Roadmap.* http://www.civicfed.org/iifs/publications/FY2015_StateofIllinoisRoadmap.

FUNDAMENTAL PRINCIPLES OF SOUND BUDGETARY PRACTICE

Principle I

ADVANCE PLANNING

Engage in multiyear financial planning and reporting

A. Make multiyear projections of sustainable revenue and current-service spending
B. Estimate the future expense and revenue impact of major legislation (e.g. fiscal notes)
C. Create and annually update a capital plan
D. Avoid reporting with single-year cash-basis accounting only
   i. Use accrual accounting where feasible
   ii. Supplement cash-basis budget reports with a clear statement of impact on future years

Principle II

SUSTAINABILITY

Avoid time-shifting of payments for current operations

A. Pre-fund deferred payment obligations with asset purchases (e.g., pensions and OPEB)*
B. Avoid borrowing for current operations
C. Avoid payment delays for current operations, such as:
   i. Increases in unpaid bills to vendors of services rendered*
   ii. Accounting shifts to pay for current expenses out of next fiscal year's revenue*
D. Avoid selling assets to pay for current operations including physical assets, financial assets, future revenue streams, depletion of pre-existing fund balances
E. Avoid paying for on-going program operations with non-recurring (one-time) revenue
F. Avoid deferred maintenance of infrastructure assets
G. Clearly account for time-shifting when it does occur (per Principle I)
H. Identify non-recurring revenue as such in budget documents

Principle III

FLEXIBILITY

Plan for shocks or cyclical fluctuations in revenue inflows or spending needs

A. Have a well-designed rainy day fund*
B. Have rules for accessing available fund balances

Principle IV

TRANSPARENCY

Issue meaningful, clear, consistent and timely budget and financial reports

A. Avoid confusion from changing budget scope or categories across years ("fund shifting")
   i. Report broad-based all-funds budget frame, not just general funds
   ii. Clearly identify revenue transfers between on-budget and off-budget funds
   iii. Clearly identify shifts in spending responsibility between on-budget and off-budget funds
B. Make budget information available online*
C. Make budget information available on a timely basis
D. Create easily understandable budget and financial reports

*One of the eight items used to evaluate state budget practices in the "Preliminary Budget Report Card" from: The Volcker Alliance. (2015). *Truth and Integrity in State Budgeting: Lessons from Three States.* http://bit.ly/1NPwpPC